Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FCC 93-428

In the Matter of	)	
Implementation of	)	
Sections of the Cable Television	)	MM Docket No. 92-266
Consumer Protection and	)	
Competition Act of 1992	)	
	)	
Rate Regulation	)	

**First Order on Reconsideration,
Second Report and Order,
and
Third Notice of Proposed Rulemaking**

Adopted: August 27, 1993 Released: August 27, 1993

Comments Due: September 30, 1993
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By the Commission: Chairman Quello issuing a separate statement; Commissioner Barrett issuing a separate statement.

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I. INTRODUCTION

1. In the Rate Order and Further Notice of Proposed Rule Making in MM Docket No. 92-266 ("Rate Order" and "Further

1.Notice")[1] this Commission adopted rules and established policies to implement cable rate regulation pursuant to the dictates of the Cable Consumer Protection and Competition Act of 1992 ("1992 Cable Act," "Cable Act of 1992" or "Act").[2] The primary results of the Rate Order were: 1) development of a process for identifying those situations where effective competition exists (and rate regulation is thus precluded); 2) establishment of the boundaries between local and state, and federal responsibilities; and 3) development of procedural and substantive rules to govern the regulation of basic service tier rates, cable programming service tier rates, equipment rates, and rates for leased access channels. The Further Notice addressed whether the Commission should refines its initial rate-setting analysis by excluding from its sample of systems facing effective competition the rates of one statutorily identified group of systems, *i.e.*, cable systems with less than 30 percent penetration.

2. The issues raised in petitions for reconsideration of the Rate Order are as numerous and as varied as the regulations and policies adopted therein.[3] With the first stages of cable rate regulation imminent, the Commission undertakes today to dispose of as many of the most pressing issues as possible, with the remaining issues to be resolved in the near future. Accordingly, this First Order on Reconsideration, Second Rate Order and Third Notice of Proposed Rulemaking, ("Rate Reconsideration") is the first of two Orders that will dispose of issues raised in petitions for reconsideration of the Rate Order.[4] It also resolves the further rulemaking issue raised in the Further Notice.

3. We find good cause under the Administrative Procedure Act to make this Order effective upon publication in the Federal

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[1] FCC 93-177, released May 3, 1993; 58 Fed. Reg. 29736 (published May 21, 1993).

[2] Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1460 (1992). The 1992 Cable Act became law on October 5, 1992. This proceeding specifically implements sections 3 (subscriber rate regulation), 9 (commercial leased access), and 14 (subscriber bill itemization) of the Act, and was commenced through the issuance of a Notice of Proposed Rule Making in MM Docket No. 92-266 ("Notice"), 8 FCC Rcd 510 (1992).

[3] For a list of parties in this proceeding, see Appendix B.

[4] Amendments to the rules are located at Appendix A.

Register.[5] As explained below, the clarifications to our rules adopted in this Order refine our benchmark system of rate regulation. It is important these changes go into effect as soon as practical, in order to facilitate compliance of cable operators with the 1992 Cable Act and the Commission's implementing regulations, which go into effect September 1, 1993. Accordingly, we will make this Order and the implementing rule changes effective upon publication in the Federal Register. We also revise our rules to make them reflect the September 1, 1993, effective date adopted in an Order on July 27, 1993.[6]

II. SUMMARY

4. Specifically, this Rate Reconsideration effects the following actions:

1) With the regard to the benchmark methodology adopted in the Rate Order for setting rates, it:[7]

* affirms the Commission's determination to set initial rates for all regulated tiers of service at a level that approximates as closely as possible that which would occur in a competitive marketplace;

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[5] The Administrative Procedure Act generally requires publication in the Federal Register of substantive rules 30 days prior to their effective date but permits substantive rules to become effective with less than 30 days advance publication in the Federal Register for good cause. See 5 U.S.C. Section 553(d)(1); see also 47 C.F.R. Section 1.427(b).

[6] Order, MM Docket 92-266, FCC 93-372 (released July 27, 1993), 58 FR 41042 (Aug. 2, 1993).

[7] The benchmark formula itself is still under review. In view of the importance of the formula to the rate regulation scheme, it will be revisited in the next reconsideration Order as soon as possible, and will be accompanied by any appropriate transition mechanisms. (One of the potentially significant issues under review, for instance, is whether the number of regulated satellite channels on a given system is an appropriate variable in setting the system's rates.) We note here that small systems, which may face disproportionate administrative burdens and costs of compliance with rate regulation, have been exempted from the rate rules until reconsideration of the benchmark formula and roll-back provisions is complete. See Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, MM Docket 92-266, FCC-389 (released Aug. 10, 1993), 58 FR 43816 (Aug. 18, 1993). Such reconsideration will include an examination of what formula adjustments or rules might be appropriate for small cable systems.

* affirms the Commission's decision to use the universe of cable systems facing effective competition, strictly as defined in the statute, as a guide for establishing the competitive rate level; and

* affirms the use of a benchmark formula based on the rates of competitive systems, in conjunction with a rate rollback based on the "competitive differential" between rates charged by competing systems and noncompeting systems, for determining each cable system's legally permissible initial rate;

2) With regard to price caps and the mechanisms for determining permissible rate increases, this Order:

* affirms that rates for regulated service set by the benchmark will be governed by a price cap mechanism once initial regulated rates are determined;

* affirms the accordance of external cost treatment to retransmission consent fees incurred after October 6, 1994, other programming cost increases, franchise fees, taxes and the costs of franchise requirements including PEG channels;

* affirms, in general and at this time, that costs associated with upgrades and other capital improvements be evaluated using cost-of-service principles and not be passed through as external costs;

* determines that only costs of meeting franchise requirements specifically enumerated in the franchise agreement will be eligible for external cost treatment;

* establishes a test for external treatment of taxes;

* lifts the limitation on programming cost increases for affiliated program services in favor of rules designed to prevent abuse of the pass-through allowance while not restricting recovery for programing cost increases that occur generally in the marketplace; and

* affirms the starting date for external costs treatment.

3) With regard to rate-setting procedures, this Order:

* rejects arguments that refunds for overcharges on the basic service tier are not permissible under the Act;

* rejects the contention that franchise authorities can specify the content of the basic tier (beyond inclusion of PEG channels) under the statute;

* allows cable operators to file rate increases quarterly while requiring that filings reflecting increases in external costs also reflect any decreases in such costs; and

* requires cable operators to file revised rates reflecting decreases in external costs no later than one year from the date on which the decrease occurs.[8]

4) This Order addresses several questions regarding the regulation of rates for equipment and for installations. Specifically, it:

* affirms the decisions regarding the type of equipment regulated with the basic service tier;

* affirms the application of the "actual cost" standard to cable programming service equipment and installations;

* holds that a cable operator's sale of equipment is unregulated when the cable operator provides subscribers the opportunity to lease the same equipment at regulated rates;

* affirms the application of the actual cost standard to additional connections;

* rejects several proposals to amend the guidelines for determining the "actual cost" of equipment on FCC Form 393, Part III; and

* provides some clarifications regarding the use of Form 393.[9]

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[8] Additional arguments regarding refunds and issues relating to the certification process and procedural requirements are not resolved in this Order. These include whether the Commission should regulate basic rates in the absence of some affirmative action by the local franchising authority, voluntary decertification, refund adjustments to account for franchise fees, whether refund liability can legally extend back to the effective date of the rules (September 1, 1993 for all but small systems), conflicts between federal and state/local FOIA laws, and means of compliance with the requirement to supply franchise authority information to subscribers when monthly bills are not set out. Each of these issues will be taken up in the next reconsideration Order.

[9] A few matters, such as questions regarding permissible charges for service changes and proper accounting for promotions and for home wiring, will be addressed in the next reconsideration

5) With regard to the guidelines and the procedures for determining whether or not a cable system is subject to effective competition, this Order:

* provides that where a cable system has elected not to serve parts of a franchise area, those parts will not be considered when defining the franchise area for purposes of the first statutory effective competition test; and

* reiterates that data regarding levels of subscription, used to establish the presence or absence of effective competition, can be provided by competitors in the aggregate.

5. Petitions concerning rules applicable to cable service generally are not addressed herein. These include questions concerning the requirement that cable systems have a geographically uniform rate structure, especially as regards bulk discounts and systems subject to effective competition; questions whether certain practices constitute evasions of the rules; the grandfathering of certain rate agreements; and subscriber bill itemizations. Questions regarding all aspects of the rules to govern leased access channels will also await resolution in the next reconsideration Order.

6. This Order also resolves the Further Notice by concluding that systems with less than 30 percent penetration should continue to be included in the universe of competitive systems used to develop benchmark rates. This result is dictated both by the clear statutory language, which defines such systems as being subject to effective competition, and by the absence of any compelling policy reason to exclude these systems from our analysis. In the Third Notice of Proposed Rulemaking, we seek comment on several critical issues, including: (1) how to apply the benchmark methodology when a cable system adds or deletes channels on a going-forward basis; (2) whether cable systems that completed rebuilds immediately before regulation, and whose rates are below the benchmark level, should be permitted to raise their rates to the benchmark; (3) whether cable operators should be required to use a consistent rate-setting approach (either benchmark or cost-of-service) for all regulated tiers of service; and (4) how systems upgrades required by local franchise agreements should be handled under the benchmark/price cap approach.

III. ORDER ON RECONSIDERATION

Order.

A. BENCHMARK ISSUES

1. Background

7. The Notice in this proceeding sought comment on several possible bases for setting rates for regulated cable systems, including: rates charged by systems facing effective competition; systems' past regulated rates; the current average rates of cable systems; and the average or typical costs of providing cable service. To aid in designing an appropriate rate-setting structure, the Commission obtained information concerning current rates, past rates, and system characteristics from a random sample of approximately 300 cable systems and from 141 systems that appeared to be subject to effective competition, as defined by the statute. This competitive sample included systems facing widespread direct competition from rival multichannel video service providers (both commercial and municipal) and systems with penetration rates below 30 percent.[10]

8. The industry survey confirmed Congress' conclusion, reflected in the 1992 Cable Act, that the average rates of systems not subject to effective competition exceed those of systems subject to effective competition. Analysis of the survey data revealed that this "competitive differential" was approximately 10 percent on an industry average.[11] Based on the statute and the survey results, the Rate Order concluded that the reasonableness of rates for the basic service tier, and the unreasonableness of rates for cable programming services, should

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[10] Section 623(l)(1) of the Communications Act of 1934, as amended, 47 U.S.C. Section 543(l)(1) provides in pertinent part:

> The term "effective competition" means that--
> (A) fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system;
> (B) the franchise area is--
> (i) served by at least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and
> (ii) the number of households subscribing to programming services offered by multichannel video programming distributors other than the largest multichannel video programming distributor exceeds 15 percent of the households in the franchise area; or
> (C) a multichannel video programming distributor operated by the franchising authority for that franchise area offers video programming to at least 50 percent of the households in that franchise area.

[11] Rate Order at para. 14, n.29.

both be determined by reference to rates of systems facing effective competition.[12]

9. Accordingly, the Commission adopted a "benchmark" approach to project for any regulated system the rates that would be charged by a similarly situated system operating in a competitive marketplace.[13] This approach will be used to set operators' initial rates. A system's actual rates that are at or below the competitive level, as determined by the benchmark formula, on the date of initial regulation will be deemed reasonable; actual rates above the benchmark-derived level will be presumed unreasonable, and must be reduced unless justified in a cost-of-service showing.[14] Such rates above the benchmark must be reduced up to 10 percent from September 30, 1992 levels,[15] (or until they reach the benchmark, if that is less than a 10 percent reduction), in order to recapture for subscribers the competitive rate differential found to exist on an industry-wide basis.[16] This same benchmark formula and rollback liability applies to all regulated tiers of service, although the rules with respect to cable programming service are triggered by the filing of a complaint.

10. Petitions for reconsideration, oppositions and replies have been filed by numerous parties challenging (and supporting) various aspects of the benchmark regulations, and comments and reply comments have been filed regarding the use of low penetration systems in the competitive sample. In addition, some of the parties seeking reconsideration of the Rate Order also addressed the issues raised in the Further Notice. Issues such as the use of a benchmark and rollback methodology for setting

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[12] Id. at paras. 205 and 387.

[13] The benchmark formula takes into account the three system variables found by the Commission's statistical analysis to have the most significant effect on the prices of the surveyed systems -- the number of subscribers, regulated channels, and regulated satellite-delivered signals. Id. at para. 210.

[14] Id. at para. 213. After a cable system's initial rates are established, its subsequent rate increases are governed by a price cap mechanism designed to keep rates at a reasonable level. This price cap mechanism is further discussed at para. 87-123, infra.

[15] Any required reduction must be taken from the system's rates as of September 30, 1992 in order to ensure a proper comparison to the benchmark and protect subscribers from potentially unwarranted rate increases since that date. Rate Order, at para. 396.

[16] Id. at para. 217.

rates, having a competitive rate as our goal in rate-setting, the propriety of using only "competitive systems" as defined in the statute to determine competitive rates, and compliance with the Administrative Procedure Act are disposed of in this Rate Reconsideration.[17]

2. Discussion

a. Effective Competition as Primary Factor

11. Various petitioners challenge the Commission's primary reliance on competitive rates in setting the benchmark rates. These petitioners contend that the Commission did not take into account the other factors listed in Sections 623(b) and (c) of the Communications Act for consideration in setting rates,[18]

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[17] Concerns about the accuracy of the random and competitive sample data used in constructing the benchmarks and the methodology and statistical analysis that were used in constructing the benchmarks, as well as some petitioners' specific suggestions of other variables they believe should be significant in the benchmark formula, will be addressed in the next reconsideration Order.

[18] Section 623(b), regarding basic service tier rates, provides in pertinent part that the Commission:

(A) shall seek to reduce the administrative burdens on subscribers, cable operators, franchise authorities, and the Commission;
(B) may adopt formulas or other mechanisms and procedures in complying with the requirements of subparagraph (A); and
(C) shall take into account the following factors:
(i) the rates for cable systems, if any, that are subject to effective competition;
(ii) the direct costs (if any) of obtaining, transmitting, and otherwise providing signals carried on the basic service tier, including signals and services carried on the basic service tier pursuant to paragraph (7)(B), and changes in such costs;
(iii) only such portion of the joint and common costs (if any) of obtaining, transmitting, and otherwise providing such signals as is determined, in accordance with regulations prescribed by the Commission, to be reasonably and properly allocable to the basic service tier, and changes in such costs;
(iv) the revenues (if any) received by a cable operator from advertising from programming that is carried as part of the basic service tier;
(v) the reasonably and properly allocable portion of any amount assessed as a franchise fee, tax or charge of any kind imposed by any State or local authority on the transactions between cable operators and cable subscribers or any other fee, tax, or assessment of general applicability imposed by a governmental

including, for instance, the factors of reasonable profits for cable operators or rates charged by similarly-situated systems. Moreover, they argue, such cost variables as system size, geographic location, and franchise and programming costs were not considered. Other petitioners contend that other sources of revenue such as advertising and shopping channels were not taken into account.

12. After reviewing petitioners' arguments, we conclude that the Rate Order properly placed primary weight on rates of systems subject to effective competition in fashioning the benchmark approach. Congress' findings, the overall structure of the Act, the statutory goal for the basic and cable programming service tiers, and the statutory factors for rate determinations all point to a strong congressional intent that cable subscribers should pay rates consistent with a level of rates that would

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entity applied against cable operators or cable subscribers;

(vi) any amount required, in accordance with paragraph (4) to satisfy franchise requirements to support public, educational, or governmental channels or the use of such channels or any other services required under the franchise; and

(vii) a reasonable profit, as defined by the Commission consistent with the Commission's obligations to subscribers under paragraph (1).

Section 623(c), regarding cable programming services rates, provides in pertinent part that:

[T]he Commission shall consider, among other factors:

(A) the rates for similarly situated cable systems offering comparable cable programming services, taking into account similarities in facilities, regulatory and governmental costs, the number of subscribers, and other relevant factors;

(B) the rates for cable systems, if any, that are subject to effective competition;

(C) the history of the rates for cable programming services of the system, including the relationship of such rates to changes in general consumer prices;

(D) the rates, as a whole, for all the cable programming, cable equipment, and cable services provided by the system, other than programming provided on a per channel or per program basis;

(E) capital and operating costs of the cable system, including the quality and costs of the customer service provided by the cable system; and

(F) the revenue (if any) received by a cable operator from advertising from programming that is carried as part of the service for which a rate is being established, and changes in such revenues, or from other consideration obtained in connection with the cable programming services concerned.

prevail if their systems were subject to effective competition.[19] Additionally, and significantly, while we ultimately based the rate-setting methodology on the rates and other characteristics of competing systems, we took all of the statutory factors into account when developing this rate regulation scheme. In this regard, it is necessary to consider the various rate regulation mechanisms employed -- benchmarks, cost-of-service showings and price caps -- not in isolation, but as part of a regulatory system that incorporates the various statutory factors.

13. For example, petitioners overlook the fact that competing businesses must charge rates that are designed to cover all relevant costs and to provide for a profit in order to remain in business. Thus, when the Commission bases benchmark calculations on the rates charged by firms subject to effective competition, it effectively accounts for the costs of providing service for those systems, and also the need for any viable company to earn a "normal" or "competitive" rate of return.[20] Also, the rate-setting formulation considered those variable system characteristics which statistical analysis showed to be the most significant, by including them in the benchmark formula.[21] The other statutory factors are provided for in the price cap allowances.[22] To the extent that petitioners are arguing that the Commission must take into account each individual system's costs and profit in setting its rates, that can be accomplished through a cost of service showing, for which the Commission has provided.[23] In sum, however, the Commission's benchmark rates are designed to adhere not only to the statutory factors but also to the Act's mandate that the administrative burden on all parties be reduced to the extent possible.[24] Primary reliance on a benchmark formula based on competitive rates, as an initial means of determining regulated cable rates, with supplemental reliance on cost of service showings, is thus a reasonable approach and is consistent with provisions of the Cable Act of 1992.

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[19] Communications Act, Section 623 (b), 47 U.S.C. Section 423 (b); Rate Order at paras. 14, 15, 180, 205.

[20] Rate Order, at para. 387 n. 946.

[21] Id. at para. 400 n. 976; Communications Act, Section 623 (b)(2) and (c)(2); 47 U.S.C. Section 543 (b)(2) and (c)(2).

[22] Rate Order, at para. 254; Communications Act, Section 632 (b)(2) and (c)(2), 47 U.S.C. Section 543 (b)(2) and (c)(2).

[23] Rate Order, at para. 264.

[24] Id. at para. 262; Communications Act, Sections 601 (1), and 623 (b)(2)(A), 47 U.S.C. Sections 521 (1) and 543 (b)(2)(A).

b. Application of the Benchmark Rates

14. Several petitioners seek reconsideration of certain specific aspects of the benchmark approach. For instance, some petitioners seek to allow systems with rates below the applicable benchmark rates to raise their rates up to the benchmark level. They contend that otherwise, the "good actors" that kept rates low before regulation will be "punished" because they may have to remain below the benchmark indefinitely. As stated in the Rate Order, however, the decision to cap the rates of operators already below the benchmark was based on the assessment that such below-benchmark rates were reasonable to each such cable system, since it voluntarily selected that rate level before regulation began.[25] Accordingly, unless the operator was acting irrationally, its chosen rate level presumably enables it to recover its costs (which most likely are lower than average).[26] Petitioners do not challenge this assessment or provide evidence that its assumptions are unfounded. In any event, as with all cable systems subject to regulation, if any operator's below-benchmark permitted rates are no longer sufficient to cover costs, it may initiate a cost of service showing.

15. Other petitioners argue that noncompeting systems with rates above the benchmark are being treated differently than competitive systems that have rates above the benchmark. Noting that the noncompeting systems will have to reduce their rates while the systems subject to effective competition will not, they claim that such different treatment of two similarly situated classes of systems is impermissible. However, these two classes

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[25] We assume that our benchmark is compensatory for systems that were rebuilt or upgraded before regulation began. We recognize, however, that some cable operators with below-benchmark rates may have foregone needed rate adjustments, such as after a system upgrade, to avoid subjecting subscribers to immediately sharp rate increases in anticipation of a series of more gradual rate changes over time. As a transitional step, we will consider permitting, on an individual basis, such operators to increase rates up to benchmark levels upon a particular showing that their are rates below the benchmark and that the onset of rules disturbed a preexisting business plan to recoup system costs over an extended period. We seek comment on this proposal in para. 145, infra.

[26] Id. at para. 232. This approach is consistent with our assessment, not challenged by petitioners, that systems whose rates are well above the benchmark level should be required to reduce those rates by a maximum of 10% (the competitive differential), at least initially, since we will assume that such systems may face higher than average costs and thus should not be required to reduce rates all the way to the benchmark. Id.

of systems are not similarly situated. A competitive system can be presumed to be charging a competitive, "reasonable" rate by virtue of the presence of competition, whereas a system free of competition, enjoying market power, cannot be presumed to be charging a competitive rate, as illustrated by our data sample and analysis.[27] The reasonable competitive rate for such a system can only be surmised by reference to the benchmark and rollback provisions derived from the sampling and analysis of the rates of competitive and non-competitive cable systems. The statute clearly states that systems that are subject to effective competition, as defined in the statute, may not have their rates regulated by the Commission or the local franchise authority.[28] Thus, the 1992 Cable Act expressly provides for the different treatment of these different classes of systems. To the extent commenters are raising questions concerning the fact that the benchmark is based on average rates of systems subject to effective competition, these questions will be addressed in the Second Order on Reconsideration.

c. Compliance with the Administrative Procedure Act

16. Some petitioners contend that the Commission has violated the Administrative Procedure Act in connection with its adoption of benchmark rules by failing to give adequate notice of "either the terms or substance of the proposed rule or a description of the subjects and issues involved."[29] They claim that the benchmark rates established in the Rate Order are not a logical outgrowth of the rulemaking process. They further claim that parties did not have notice or opportunity to comment on the basic aspects of the methodology that would be used to determine the benchmark. For instance, they claim that none of the following items were disclosed in this proceeding until the Rate Order: (1) the statistical tool or model that would be used in the regression analysis; (2) which factors would be significant in determining rates; (3) the assumptions that would be made in connection with creating the benchmark; (4) the adjustments that would be made to data; and (5) the treatment of uncertainty in the statistical results.

17. The courts have long held that in applying 5 U.S.C. Section 553(b)(3), the notice requirement is satisfied so long as the content of the agency's final rule is a "logical outgrowth"

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[27] Rate Order, at Appendix E.

[28] Communications Act, Section 623(a)(2), 47 U.S.C. § 543(a)(2).

[29] 5 U.S.C. Section 553(b)(3).

of its rulemaking proposal.[30] Moreover, the focus of the "logical outgrowth" test has been "whether ... [the party], ex ante, should have anticipated that such a requirement might be imposed."[31] Furthermore, the "[n]otice need not contain every precise proposal which the agency ultimately may adopt as a rule. Rather notice is sufficient if the description of the 'subjects and issues involved' affords interested parties a reasonable opportunity to participate in the rulemaking."[32] If an agency were forced to adopt only rules as they were originally proposed, it would result in an interminable step-by-step process of a new notice and comment each time the rules slightly deviated from the original proposal."[33]

18. The Notice went into considerable detail describing the proposals for creating a benchmark for cable rates and soliciting comments from parties.[34] Indeed, the proposal ultimately adopted by the Commission, *i.e.*, benchmark rates based on rates charged by systems facing effective competition, was extensively discussed in the Notice.[35] Notification was given that, to the extent sufficient data was available, regression analysis or some other statistical technique could be used to determine how rates varied due to different characteristics. Petitioners thus had an opportunity to comment on the very form of benchmark ultimately selected by the Commission. While it is true that the precise benchmark formula was not included in the Notice such specification was impossible until the Commission conducted its statistical and regression analysis. However, the sample database was released to the public and an opportunity for public comment on the data was provided.[36] The choice of the specific statistical method in calculating the benchmark rates is

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[30] See, e.g., Aeronautical Radio, Inc. v. FCC, 928 F.2d 428, 445-46 (D.C. Cir. 1991) and United Steelworkers of America v. Marshall, 647 F.2d 1189, 1221 (D.C. Cir. 1980), cert. denied, 453 U.S. 913 (1981).

[31] Small Refiner Lead Phase-Down Task Force v. EPA, 705 F.2d 506, 549 (D.C. Cir. 1983).

[32] Trans-Pacific Freight Conference of Japan/Korea v. Federal Maritime Commission, 650 F.2d 1235, 1248 (D.C. Cir. 1980) ("Trans-Pacific").

[33] Trans-Pacific, 650 F.2d at 1249.

[34] Notice, *supra* at paras. 520 - 23.

[35] Id. at 521.

[36] Public Notice No. 31934, released February 24, 1993.

an appropriate matter for agency discretion."[37]

19. Petitioners further argue that the Commission failed to give "a concise general statement of [the rule's] basis and purpose," because the Commission did not explicitly address certain comments."[38] This argument, however, must also be rejected. "This section has never been interpreted to require the agency to respond to every comment, or to analyze every issue or alternative raised by the comments, no matter how insubstantial."[39] The Rate Order took into account all significant comments concerning the establishment of benchmark rates.

20. Finally, some petitioners contend that the Commission did not respond to concerns raised by commenters that the data from overbuild systems was skewed because of price wars and that there were flaws in the data identified by NCTA. However, NCTA did not indicate in its original comments, and does not indicate in its petition for reconsideration, what effect, if any, the alleged errors in the sample data base would have in computing the benchmark rates. Accordingly, the Commission did not ignore any relevant factors in its decision.[40]

B. DEFINITIONS AND FINDINGS OF EFFECTIVE COMPETITION

21. Under the 1992 Cable Act, the rates of a cable system may be regulated only if the system is not subject to "effective competition." The Act provides that effective competition is presumed to exist if any one of three tests is fulfilled.[41] The Rate Order set out the rules interpreting and implementing these statutory tests, and explained how various new video programming distribution services would be considered under the relevant tests. Several parties have requested reconsideration of discrete aspects of these rules.

1. Low Penetration Systems.

22. Under the first statutory test, effective competition exists if "fewer than 30 percent of the households in the

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[37] See BASF Wyandotte Corp. v. Costle, 598 F.2d 637, 655 (1st Cir. 1979).

[38] 5 U.S.C. Section 553(c).

[39] Thomas v. Clark, 741 F.2d 401, 408 (D.C. Cir. 1984).

[40] Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971).

[41] Communications Act § 623(l), 47 U.S.C. § 543(l).

franchise area subscribe to the cable service of a cable system."[42] The Commission adopted a rule repeating almost *verbatim* the language of the statute and stated that, for purposes of applying this rule, the subscribership of each cable system in a franchise area will be measured separately and not aggregated with other systems.[43]

23. Several groups of franchising authorities urge the Commission to define the term "franchise area" for purposes of the first effective competition test as "the area within a franchising authority's jurisdiction that an operator is required to service or that it in fact serves" or as the de facto (homes passed) rather than de jure (authorized) franchise area. In response, several cable operators contend that this approach conflicts with the express language or plain meaning of the statute and thus may not be adopted by the Commission.

24. Notwithstanding the concerns expressed by franchising authorities regarding the coverage of this statutory provision, we are not in a position to alter the plain language of the statute through our regulations. The term "franchise area" is used for a variety of purposes within the statute[44] and our rules and has a commonly understood meaning in the industry and in regulatory parlance. A franchise area is the area a system operator is granted authority to serve in its franchise. Thus, the substitution of a "homes passed" for "homes in the franchise area" test does not appear to be consistent with the plain language of the statute. Moreover, because franchise authorities themselves have both the authority to define the area to be served[45] and anti-"redline" authority[46], they are not without the

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[42] Communications Act, Section 623(l)(1)(A), 47 U.S.C. § 543(l)(1)(A).

[43] Rate Order at para. 18; 47 C.F.R. § 76.905(b)(1).

[44] The same terminology, for example, is used in the second and third effective competition tests, in the SMATV and MMDS cross-ownership restrictions (Section 613(a)), and in the franchise award (Section 621(a)(4)) and renewal provisions (Section 626(a)(1)).

[45] Section 621(a)(4) states that: "(4) In awarding a franchise, the franchising authority -- (A) shall allow the applicant's cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area."

[46] Section 621(a)(3) provides that: "In awarding a franchise or franchises, a franchising authority shall assure that access to cable service is not denied to any group of potential residential subscribers because of the income of the residents of the local

ability to themselves address some of the concerns raised in the reconsideration petitions.

25. We do believe, however, that there may be some limited situations (such as, for example, where a system operator has county-wide operating rights but has determined to serve only a specific named community within that area) where use of a more restricted "franchise area" definition may be both appropriate and consistent with the statutory language. An affirmative decision by a system operator to restrict service logically redefines its franchise area in terms of the objectives of this provision. Accordingly, we will permit franchise authorities to demonstrate the boundaries of such a redefined franchise area. Such a showing, however, will be limited to situations in which a system operator has itself, through its own conduct, self-defined the areas to be served to such an extent that this redefined area accurately portrays the operator's "franchise area." The fact that a franchise area has not as yet been filled out by construction of a system would not by itself be taken as redefining the service area.

2. Procedures Regarding Effective Competition Demonstrations.

26. A cable operator is presumed not to be subject to effective competition and carries the burden of rebutting this presumption with evidence of the presence of effective competition as defined in the Act. To obtain access to information necessary to rebut this presumption, cable operators may request from a competitor information regarding the competitor's reach and penetration, if such information is not otherwise available.[47] The rule requires that competitors must respond to such requests within 15 days, and that responses may be limited to numerical totals.

27. One petitioner alleges that some cable operators are requesting that competitors reveal, pursuant to the above rule, specific subscriber information, including lists of subscribers and their addresses. As stated in the Rate Order, however, "responses may be limited to the numerical totals needed to calculate the distributor's reach and penetration in the franchise area."[48] A competitor need only supply these aggregate totals. Lists of subscribers and their addresses clearly do not fall into this category and should not ordinarily be disclosed. If cable operators are alleged to have abused their right to

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area in which such group resides."

[47] 47 C.F.R. § 76.911(b)(2).

[48] Rate Order at para. 44.

request effective competition data from a competitor, the Commission will, as indicated in the Rate Order, deal with such situations on a case-by-case basis."

28. A joint petition filed on behalf of several cable MSOs expresses concern that some cable operators may not be able to demonstrate the presence of effective competition in sufficient time to stay a franchising authority's certification to regulate basic cable rates, because competitors may not respond to requests for information on their penetration and reach within 15 days. The petitioners are concerned that these competitors have no incentive to cooperate with cable operators and that there is no enforcement mechanism for this rule.

29. We believe that cable's competitors generally should be able to comply with requests for aggregate data on reach and penetration within the required 15 days. Since such information is likely critical to a competitor's billing and marketing efforts, it should be readily available. The joint petitioners mere speculate that competitors will intentionally withhold or delay providing information; there is currently no evidence of such conduct. Moreover, many of the most significant competitors to incumbent systems, such as other cable systems and MMDS systems, are either licensed or regulated in part by the Commission, and enforcement proceedings thus can be instituted against them should they deliberately fail to respond as required. And, as indicated in the Rate Order, if unresponsiveness does threaten to become a prevalent problem, the Commission could require periodic reporting from all competitors.

30. Finally, relief can be provided to cable systems in individual cases of unresponsiveness as necessary and appropriate. Such relief could consist of an extension of time to file a petition for reconsideration challenging a franchising authority's certification. Alternatively, an operator can file a request for revocation of a franchising authority's certification pursuant to Section 623(a)(5) of the Communications Act, even after the time for filing reconsideration of a franchising authority's certification has passed.

C. TIER NEUTRAL RATE-SETTING METHODOLOGY

31. In the Rate Order, the Commission adopted a tier-neutral framework for rate-setting that is the same benchmark formula and rollback requirements are to be applied to basic tier services and to cable programming tier services. It concluded that the Act's directions, on the one hand, to "ensure that rates

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" Id.

for the basic service tier are reasonable,"[50] and, on the other hand, to "establish ... criteria for identifying, in individual cases, rates for cable programming services that are unreasonable,"[51] merely reflect the different procedural schemes Congress adopted for these different tiers -- that is, basic tier rates are to be pre-approved by local franchise authorities and cable programming tier rates are to be addressed by this Commission and only when challenged by a complainant."[52] Some parties had argued that different regulatory schemes were required for basic cable and cable programming services because the factors listed in the Act to be considered in determining the appropriate rate level for each tier differed somewhat. The Commission held, however, that the differently stated factors did not mandate different rate-setting approaches, but rather could accommodate the same rate standard for both tiers if that standard adequately balanced, and took into account, the respective factors for each tier.[53] Moreover, the benefits of tier neutrality were found to outweigh other considerations that would favor adoption of different rate standards for the basic and cable programming service tiers.[54] Specifically, the tier-neutral approach removes any incentive for moving programming from the basic to cable programming service tiers, or *vice versa*, and reduces the administrative burdens on cable operators and regulators by greatly simplifying the rate-setting process."[55]

32. A number of petitioners, primarily cable operators, reiterate their arguments that rates for basic and for cable programming service tiers should be regulated by different standards, given the different factors for consideration stated in the Act. But these petitioners offer no new insight on this analysis. Their arguments were fully considered and rejected in the Rate Order and are not extensively reanalyzed here. Accordingly, we deny their requests for reconsideration of our decisions on this issue. A few petitioners, however, have raised new arguments that we will now address.

33. Time Warner and Newhouse contend that, because the tier neutral scheme averages all tier costs into an initial average per-channel rate, it violates the statutory directive

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[50] Communications Act, Section 623(b), 47 U.S.C. § 543(b).

[51] Communications Act, Section 623(c), 47 U.S.C. § 543(c).

[52] Rate Order at para. 389.

[53] Rate Order at para. 389 and n. 949.

[54] Id.

[55] Rate Order at paras. 196-197.

that the Commission take into account only those joint and common costs that are properly allocable to the basic service tier when developing rate standards for that tier."[56] This argument is unavailing. This statutory provision provides that only a reasonable allocation of joint and common costs should be allocated to the basic service tier, but leaves to the Commission's discretion the determination of what is a reasonable allocation. The benchmark methodology uses per channel rates established by averages, but it then multiplies that per-channel rate by the number of channels in a given tier in order to establish the permissible rate for that service tier. This approach provides a reasonable allocation of rates (and presumably costs) in that it is in direct proportion to the level of service provided on each tier, as measured by the number of channels of service supplied to the subscriber. If petitioners' argument is meant to assume that non-basic tier costs are higher than basic tier costs, they do not demonstrate that this is necessarily the case. Moreover, one reason for the adoption of tier neutrality was to eliminate any incentive for operators to move services to other tiers where they could charge relatively higher prices without necessarily corresponding higher costs."[57]

34. Booth contests the Commission's premise that allowing operators to charge relatively more for cable programming services would result in a "stripped down" basic tier, and insists that the Commission has no evidence of this. Our longstanding experience with rate regulated companies, however, has taught us that such entities have every incentive to maximize revenues to the extent permitted by regulation."[58] In the instant case, it is entirely likely that a cable operator who could maximize revenue by moving programming services to the tier that enabled him to charge the highest per channel rate would do so. It is well within our discretion to make such predictive determinations, Booth's contrary claims notwithstanding."[59] Moreover, some record evidence indicates that operators were in fact retiering in anticipation of the adoption of rate regulations."[60]

35. Affiliated and Liberty argue that the tier-neutral

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[56] Communications Act § 623 (b)(2)(c)(iii) 47 U.S.C. § 543(b)(2)(C)(iii).

[57] Rate Order at para. 196.

[58] See cases cited at n.204, infra.

[59] FCC v. National Citizens Committee on Broadcasting, 436 U.S. 775, 814 (1978).

[60] See Austin Reply Comments at 10-11.

scheme creates an incentive to offer on a per-channel basis the programming now offered on tiers, noting that such *a la carte* programming is not regulated by the Cable Act. However, any such incentive to avoid regulation of the rate for a programming service (or services) is created by the statute itself and occurs irrespective of tier neutrality in rate setting. Even in the absence of tier neutrality, rates on all tiers would be regulated to "reasonable" competitive levels. The desire to avoid such regulation would seem primarily a function of the actual rate permitted under the regulation. Additionally, restructuring program offerings to provide more *a la carte* services is not *per se* undesirable, as offering programming on a per-channel basis increases consumer choice, which is one of the goals of the Act.[61] Moreover, as noted in the Rate Order, it is not clear that operators, as a business matter, have unlimited ability to shift programming from tiers to per-channel offerings.[62]

36. Finally, Northland and Affiliated Regional Communications contend that tier neutrality eliminates any incentive to carry high-quality programming as part of a regulated offering. This argument, however, ignores the fact that the benchmark calculation is based on the rates of operating (and thus presumably viable) cable systems subject to effective competition, which incur programming costs, including the costs for high-priced programming services. Also, high-priced programming should have some value to the system from a marketing, penetration, and customer satisfaction standpoint in order to justify its carriage; any exceptional price can be offset by the numerous lower-priced and no charge programming services carried by cable systems. To the extent new program services may come at a relatively high price, their treatment is addressed in the Third Further Notice of Proposed Rulemaking. Finally, as a regulatory matter, the operator retains the option to offer any or all programming on an unregulated per-channel basis, or to submit a cost-of-service showing rather than rely on the benchmark approach. Accordingly, these petitions for reconsideration of the tier neutral methodology for rate setting will be denied.

E. RATE REGULATION OF EQUIPMENT AND INSTALLATIONS

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[61] See, e.g., H.R. Rep. No. 628, 102d Cong., 2d Sess. at 90 (1992) ("House Report") ("[p]er channel offerings available to subscribers ... can enhance subscriber choice and encourage competition among programming services"); S. Rep. No. 92, 102d, 1st Sess. at 77 (1991) ("Senate Report") (noting that unbundling allows subscribers to choose only those programs for which they wish to pay).

[62] Rate Order, at n. 1161.

37. Section 623(b)(3) of the Communications Act requires the Commission to establish standards, based on actual costs, for the rates charged for equipment and installation used to receive basic cable service on one or more outlets. Pursuant to Section 623(c) of the Communications Act, the Commission also must establish criteria to determine whether rates for cable programming services, including the installation and rental of equipment used to receive such programming, are unreasonable. This section addresses petitions for reconsideration discussing the equipment to be regulated, the manner in which rates charged for equipment and installations shall be determined and the relevant entries on Form 393 for calculating such rates.

1. Equipment Covered By Basic Service Regulation

38. Section 623(b)(3) directs the Commission to establish standards for setting, on the basis of actual cost, the rate for lease of equipment used by subscribers to receive the basic service tier, including converter boxes and remote control units, and lease of monthly connections for additional television receivers.[61] The Rate Order stated the Commission's belief that Congress intended the actual cost standard to apply broadly to all equipment used to receive the basic service tier, even if it is also used to receive other cable services.[62] The Commission concluded that Congress' decision to change the terminology from "equipment necessary by subscribers to receive the basic service tier," found in the House Report, to "equipment used by subscribers," (emphases added) found in the Conference Report and adopted in the Act, was significant and was specifically intended to broaden the class of equipment subject to regulation on an actual cost basis.[63] The Rate Order also concluded that Congress had decided that equipment would be regulated unless a finding was made that the entire cable system was subject to effective competition.[64]

39. Several petitioners, primarily cable operators, seek reconsideration of the Commission's broad reading of "equipment used to receive the basic service tier." These parties argue that only certain fundamental equipment used to receive the basic service tier, and not equipment whose use for basic service, is only incidental to its primary purpose, should be regulated

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[61] Communications Act § 623(b)(5) 47 U.S.C. § 543(b)(3).

[62] Rate Order at para. 283.

[63] The Conference Report noted that "this change gives the FCC greater authority to protect the interests of the consumer." Conference Report at 64.

[64] Rate Order, at para. 282.

pursuant to the "actual cost" standard specified in Section 623(b) of the Communications Act. Under this approach, equipment installed when the subscriber chooses to have access to cable programming services would be regulated under the "not unreasonable" standard in Section 623(c) and equipment used to access unregulated per-channel or per-program services would remain unregulated, even if that equipment also accesses signals on the basic service tier. The petitioners argue that, when substituting the phrase "used" to receive the basic service tier for the phrase "necessary" to receive the basic service tier, Congress merely intended to broaden the language in the Act so as to include remote control devices and other ancillary equipment used by basic subscribers which might not be considered "necessary" for basic service. Several cable operators contend that, if Congress intended all equipment to be priced on the "actual cost" standard, the Cable Act would not have specifically referred to descrambling equipment used to receive pay services by a basic-only subscriber. These parties argue that our interpretation of the Act makes this reference in Section 623(b)(3)(A) superfluous because such equipment would already have been included under the actual cost standard.

40. Further, some petitioners note that regulating as part of basic service the equipment used to deliver cable programming services or pay services renders meaningless Congress' decision to add equipment and installation to the definition of cable programming service.[47] In this regard, Cablevision states that if Congress intended a broad reading of "equipment used to receive the basic service tier," it would not have chosen to include equipment in the definition of cable programming services. In contrast, NATOA believes that the Commission is correct in subjecting equipment "used" to receive basic service to actual cost regulation regardless of whether it is also used to receive any other programming service.

41. We affirm our prior conclusion that Congress intended the actual cost standard to apply broadly to all equipment used to receive the basic service tier. Notwithstanding petitioners' reiteration of their prior arguments, we continue to believe that the interpretation in the Rate Order of the legislative history, including the changes in the language in Section 623(b) and in the definition of cable programming service is correct.[48]

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[47] Conference Report at 66.

[48] We also note that the provision in Section 623(b)(3)(A) subjecting to actual cost regulation the addressable converters needed for a basic-only subscriber to receive pay services was included to ensure that "buy-through" protection would not be circumvented by high equipment rates. We thus reject petitioners' argument that the inclusion of addressable converters in that

Moreover, we note that if we were to adopt a narrow interpretation of "used to receive the basic service tier," as advocated by several of the petitioners, only a small percentage of equipment would be subject to regulation under the "actual cost" standard specified in Section 623(b) of the Communications Act. According to April 1993 estimates, 74 percent of cable households receive some per-channel service along with basic cable.[69] Many of these subscribers use converters to receive their pay services, the rates for which would not be regulated under petitioners' interpretation of the Act.[70] It is thus apparent that adoption of petitioners' approach would result in a significant amount of unregulated equipment, thereby undermining Congress' concern over the high rates charged for cable equipment.[71]

42. We further observe that Congress intended that our regulations establish equipment rates similar to those that would exist in a competitive environment. Under the "actual cost" standard, cable operators recover their costs including a reasonable profit. This will result in rates comparable to those that would exist in a competitive environment, thus subjecting a reasonable amount of equipment to a standard that furthers Congress' intention.

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subsection reveals a congressional intent to significantly restrict the amount and type of equipment that should be subject to the actual cost standard.

[69] See "Cable Television Developments," NCTA, June 1993 at 1-A (citing Paul Kagan Associates, Inc., "Marketing New Media," April 19, 1993 at 4).

[70] We recognize that, pursuant to the "buy-through" provisions of § 623(b), equipment in some of these households will be regulated under the "actual cost" standard. Congress has estimated, however, that only a quarter of all cable systems currently are technologically capable of offering to basic subscribers pay services without "buying-through" intermediate service tiers. S. Rep. No. 102-92, 102d Cong. 2d Sess. (1992), at 77. Moreover, it is unclear how many of the subscribers served by such systems in fact purchase only basic and premium services. Thus, it is entirely possible that the number of subscribers protected by the actual cost standard as applied to their converters is actually very small.

[71] Congress stated that it is "concerned that cable operators have been leasing equipment at rates that far exceed its cost. The purpose of [Section 623(b)(3)] is to require cable operators to price these items fairly, and to prevent them from charging prices that have the effect of forcing subscribers to purchase these items several times over the term of the lease." House Report at 83-84.